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TO:

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1 - NIO/USSR - FYI
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FORM NO. 241 REPLACES FORM 36-8 (47)
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SECRET NOFORN

DDI- 7088/82

THE UNDER SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301

POLICY

28 AUG 1982

In reply refer to:
I-24496/82

MEMORANDUM FOR CHAIRMAN, NATIONAL INTELLIGENCE COUNCIL

SUBJECT: U.S.S.R.: Political Side Effects of the Hard Currency Problem (U)

Harry,

(S) Thank you for sending me the typescript memorandum on the Soviet hard currency problem. Rigorous CIA analysis of this problem will support U.S. efforts to exacerbate current Soviet economic difficulties and force diversion of Soviet resources away from the military sector.

(S) The present paper is a good start on the problem. The policy community would benefit from more detail and analysis, particulary on the policy implications of the trends you identify. I hope that the attached suggestions by my staff (Tab 1) will be helpful in the final revision of this paper. They represent areas of continuing interest to us. The attached DIA memorandum may also be useful (Tab 2).

Fred

Fred C. Ikle

Attachments
a/s

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DECLASSIFY AUGUST 17, 1990

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Approved For Release 2007/05/29 : CIA-RDP83T00966R000100060033-9

DoD SUGGESTIONS ON SOVIET HARD CURRENCY PROBLEM

(C) Generally, the text needs to be fleshed out with more economic data, examples, and analyses of trends and implications for U.S. policy. Basic data on Soviet economic trends and prospects and on Soviet aid to other countries should be readily available. The following comments touch on specific sections of the draft. The questions are ones of continuing DoD interest.

(C) Soviet Union. Summarize more fully the current Soviet economic situation and prospects. The reader gets no sense of the dimensions of the Soviet problem. Cite Soviet hard currency revenues for the past few years and recent months to back up the statement that the hard currency position has worsened in the past year. The present description may be accurate, but it begs for hard data. What quantitative estimates can be offered for the three analytical points in the middle of page 27? Given the importance of natural gas exports for hard currency earnings, it would be useful to indicate the range of likely gas revenues in terms of varying degrees of success in completing the West Siberian pipeline and selling gas to Western Europe.

(S/NF) What domestic investment projects has the U.S.S.R. scaled back or postponed (page 3)? What types of industrial equipment purchases have been reduced? What will the effect be on Soviet purchases of Western technology? Does the East-West Trade paragraph indicate a Soviet tendency to cut back consumer oriented projects before industrial projects? What evidence (direct or indirect) is there as to how the hard currency problem will affect Soviet military spending? In general, what do present and prospective Soviet choices to meet their hard currency problem tell us about Soviet economic priorities? What modifications (if any) do these choices suggest in the Agency's recent estimates of Soviet economic prospects and policies?

(S) In view of the Versailles summit's decision on limiting credits to the East, it would be very useful to push the analysis of Western credits a little harder (page 2). What types of Western credits would most exacerbate Soviet hard currency problems? What sectors of the Soviet economy are most vulnerable to Western economic pressures of this type? What evidence is there as to which Western countries the Soviets consider most likely to restrict credit and which least likely? What economic incentives and/or political concession would the U.S.S.R. be likely to make in order to maintain the present level of Western credits? Put differently, when it comes to a crunch, how important are these credits to the U.S.S.R.?

(S) Eastern Europe. What will be the effects on imports and on GNP of the Soviet squeeze on Eastern European credit? What is the relative impact of reduction of Soviet economic support compared to other pressures on these economies? (It would be useful

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to integrate some of the findings in CIA's EUR 82-10070, "Eastern Europe: Shrinking Market for West European Exports," which approaches the problem from the East European perspective.) What effect will the Soviet cutback have on relative economic growth rates among the different Eastern European countries?

(S) Which Eastern European countries face the greatest prospects of consumer dissatisfaction and which face lesser prospects? What prospects are there of unrest or revolution on the scale of Poland? To what degree might such consideration lead the Soviets to reduce their delivery of natural gas to Western Europe in order to ease the energy situation in Eastern Europe? How seriously does the Agency take the "debate" over Eastern European contributions to Warsaw Pact force modernization (page 6)? What effect would selected reductions in Eastern European contributions have on projections for future Pact military capabilities? What specific gains -- for Hungary, for the bloc and COMECON and for the U.S.S.R. -- do the Soviets see from Hungary's joining the IMF? What opportunities do the projected economic difficulties offer U.S. policy in each country and in the region?

(S/NF) LDCs. It would be useful to describe the level of economic and military aid to selected LDCs and revolutionary movements over the past few years. This will allow the reader to see the present problem in perspective and help identify any trends. A table would be useful, but analysis is also necessary in order to put such aid in the context of Soviet foreign policy. In which specific LDCs does the U.S.S.R. plan to reduce its military advisory program? How much might these programs be reduced? What would be the military and political impact? How does the Agency assess the implications of each of the "belt-tightening" measures listed on pages 5 and 6? What effect will these measures have on relations of each country with the U.S.S.R.? Do the Soviets anticipate any serious losses in political influence? Some of these cases (Vietnam, Cuba, Nicaragua) suggest holding the line at present levels of aid rather than belt tightening. What are the "regions important to U.S. interests" where the Soviets will continue to extend military assistance despite the hard currency problem. Granting the difference between military assistance and economic assistance, the final paragraph in the memorandum (pages 6-7) suggests that the hard currency problem will not affect Soviet economic subsidies where they really matter to Soviet leaders. This gives the paper (like the Summary on page 1-2) an "on the one hand...; on the other hand..." quality that makes it difficult to judge Soviet priorities.

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DIA/DB-4
21 Jul 82

Hard Currency Cost of Soviet Aid to Client States (U)

1. (U) In providing economic support to client states the Soviet Union incurs hard currency costs both directly and indirectly.

- Direct: Purchases on world markets of grain, flour, rice, sugar and other foods not available from the food deficit Soviet economy.

- Indirect: Oil, primarily refined products, which could have been sold to Western customers.

  -- Opportunity cost rising sharply with rising world oil prices; oil is the USSR's major hard currency export.

  -- Shipping: Loss of revenue to own fleet and need to charter foreign flag vessels.

2. (S) Supporting the faltering economies of Cuba, Vietnam and Afghanistan is the major factor responsible for the sharp rise in Soviet hard currency costs, estimated to have reached about $2 billion in 1980 to these major claimants.

- Cuba: $1.1 billion in 1980, Havana advised by Moscow in 1981 that this level was Soviet limit.

- Vietnam: $740 million in 1980, Soviets reduced level somewhat in 1981.

- Afghanistan: $240 million in 1980, aid level believed to have stayed constant in 1981.

3. (S) Soviet refusals over the past two years to increase economic support to revolutionary regimes in Ethiopia, Angola, Mozambique and Nicaragua reveal that reducing associated hard currency costs is a major factor.

4. (S) The Soviets' worsening hard currency outlook increases their perception of the hard currency burden of supporting client states.

- 1980 hard currency costs accounted for 10 percent of hard currency export earnings.

- The 1980 hard currency trade deficit of $2.4 billion resulted partially from the $2 billion in hard currency aid extended to Cuba, Vietnam and Afghanistan.

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Declassify on 21 July 1988

5. (S) The $2 billion is a minimum estimate due to the difficulty in determining the net hard currency cost of Soviet support to revolutionary regimes. Furthermore, direct Soviet support to Poland of approximately $1.3 billion in 1980/1981 has put further strain on the Soviet hard currency position.

SECRET

C/NIC

THE DIRECTOR OF CENTRAL INTELLIGENCE

WASHINGTON, D.C. 20505

DDI #6494-82
9 August 1982

National Intelligence Council

MEMORANDUM FOR: The Honorable Fred C. Ikle
Under Secretary for Policy
Department of Defense

FROM: Henry S. Rowen
Chairman, National Intelligence Council

SUBJECT: USSR: Political Side Effects of the Hard Currency Problem

Fred:

1. It seems that our DDI Soviet people anticipated your request for a study on the impact of the Soviet hard currency shortage. The attached study was prepared as a typescript memo. It is to be expanded somewhat, to include more specifics, for publication as an Intelligence Assessment in about two weeks.

2. Please let me know whether the paper generally meets your needs. In any event, we would welcome any suggestions you may have that can be taken into account as the revision of the paper proceeds.

Harry

Henry S. Rowen

Attachment,
As stated

25X1

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25X1

DDI #6494-82
9 August 1982

SUBJECT: USSR: Political Side Effects of the Hard Currency Problem

DCI/NIC/NIO/Econ:MErnst [redacted] (9 Aug 82) 25X1

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Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

28 July 1982

MEMORANDUM

USSR: POLITICAL SIDE EFFECTS OF THE HARD CURRENCY PROBLEM [redacted] 25X1

SUMMARY

Faced with tighter hard currency supplies and potential Western credit restrictions, Moscow is trying to conserve foreign exchange, in part by reducing support to dependent allies and clients. In Eastern Europe, the Soviets reportedly are reducing subsidized oil exports and adopting a tougher loan policy. In the Third World, subsidization of oil deliveries to some countries is being cut back, and Moscow's hard currency assistance has become more niggardly. Even important clients such as Vietnam have been affected. [redacted] 25X1 25X1 [redacted]

This policy almost certainly will increase problems in bilateral relations with East European and Third World countries. Many of them have been seeking expanded Soviet assistance and will be unhappy with Moscow's tougher stance. On the other hand, the Soviets remain willing to continue military assistance in Third World regions important to US

This memorandum was prepared by [redacted] Foreign Policy Issues Branch, Policy Analysis Division, Office of Soviet Analysis. Comments may be addressed to Chief, Policy Analysis Division on [redacted] 25X1 25X1

[redacted] [redacted] 25X1 25X1

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SECRET [redacted]

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interests, since they view arms aid and sales as a major source of influence and foreign exchange. Hard currency sales probably will be pushed harder than previously although many important customers may be less able to pay because of deteriorating trade balances. 25X1

Growing Hard Currency Problems

Soviet hard currency revenues probably will remain level or even decline in real terms during the next several years as Moscow's need for Western goods and technology increases. The Soviet economy's slowdown is raising the importance of imports in helping to maintain productivity and reduce industrial and food supply bottlenecks. However, the USSR's hard currency position has worsened in the past year, due primarily to weaker demand for its oil exports and to sharply increased grain imports after a string of poor harvests. The Soviets' prospects for sustaining their current level of hard currency earnings, moreover, are bleak. Our analysis indicates that:

- Oil exports will decline.

- Rising gas exports probably will not offset fully the drop in oil revenues, even if the pipeline to Western Europe is built.

- Real earnings from other exports, including arms, are unlikely to grow appreciably. 25X1

Moscow probably does not see substantially increased reliance on Western credits as a solution to the decline. Both Western bankers and the financially conservative Soviet leaders presumably would be reluctant to substantially increase the Soviet debt burden. Moreover, the USSR apparently believes that concrete Western credit restrictions might become a reality, as Soviet State Bank Chairman Alkhimov indicated during a conversation with West German Economics Minister Lambsdorff in May. Although the vague language of the agreement on credits achieved at the Versailles summit in June and the subsequent disarray in Western ranks probably have eased Soviet apprehensions, Moscow probably still recognizes that credits will be less available than in the 1970s. 25X1

 25X1

Cutting Corners Around the Globe

With tighter hard currency supplies in mind, the Soviets are reducing their expenditures of foreign exchange across the board. Trade with the West, economic support of Eastern Europe, and assistance to less developed countries are being affected. Although we cannot yet estimate the total economic benefits to the USSR of such reductions, cutbacks in imports of Western goods and in exports to allies of oil at below-market prices could bring potential savings of a few billion dollars. [redacted] 25X1

East-West Trade

Several domestic investment projects requiring Western goods and technology have been scaled back or postponed. Although most cutbacks reportedly will affect consumer-oriented projects, purchases of some industrial equipment also have been reduced below earlier targets, according to Western business sources. Imports of certain mining and construction vehicles, for example, reportedly will be cut this year because of foreign exchange constraints. Soviet sources report that USSR overseas commercial offices and even athletes competing abroad have been ordered to minimize local hard currency purchases. [redacted] 25X1

Eastern Europe

Recent reporting indicates that hard currency worries have been responsible for a reduction in Soviet economic support to several East European countries. [redacted] 25X1 [redacted] 25X1 Moscow cited the pressures of financing increased grain imports as a major reason for cutting subsidized oil deliveries to Czechoslovakia, East Germany and Hungary this year by at least 10-15 percent below contracted volumes.[a] Similarly, the Soviets are trying to determine how much oil Bulgaria actually needs, suggesting that cutbacks will probably come soon. We believe that Moscow is motivated partly by a desire to spread the costs among its East European

[a] [redacted] 25X1 the Soviets have told Berlin that additional cuts in 1982 deliveries will be made on top of those announced last year. Although no reason was given for the cutback, the increased likelihood of another poor grain harvest this year and the need for continued massive food imports may have triggered Moscow's response. [redacted] 25X1

[redacted] 25X1

allies of supporting the Polish economy but also by an intent to free up oil for sale in the West for hard currency needed for grain and other imports. Preliminary trade data indicate that Soviet oil exports to the West increased substantially in the first quarter of 1982. The USSR's projected requirement for above-average grain imports in the coming years, moreover, will probably extend the oil delivery cutback beyond 1982. [redacted] 25X1

Moscow's need for hard currency likewise has prompted a tougher loan policy toward other Communist countries. According to a Western intelligence source, in late March the Moscow Narodny Bank in London was asked to raise $260-320 million; $160 million of this was to come from forcing the East Europeans to repay several loans when due, rather than renewing the loans. Yugoslavia and Czechoslovakia reportedly were to pay off all Soviet loans coming due, and Hungary half of its maturities.[b] [redacted] 25X1

Developing Countries

Moscow's belt-tightening apparently also has resulted in strained economic relations with some less developed countries, including some key clients. Some indications in recent months of Moscow's tougher stance are that:

- Recent public Soviet statements suggest that Vietnam's pleas for increased subsidized shipments of oil and food have been turned down.

- Reductions in Soviet oil shipments to Cuba in 1982 were considered, [redacted] although the Soviets agreed instead to provide financial incentives for Cuba to cut oil consumption. 25X1

- Nicaragua, despite the economic cooperation pledged during junta coordinator Daniel Ortega's visit to Moscow in May, has still not obtained the substantial level of Soviet hard currency aid it has been seeking since 1980.

- [redacted] the Soviets refused to make emergency arms deliveries to Luanda during South Africa's incursion last summer unless it paid hard currency in cash. 25X1

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[b] Bulgaria, East Germany and Cuba were to repay one-fourth of their maturities. [redacted] 25X1

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[redacted] 25X1

[redacted] 25X1

- [redacted] Brezhnev in late May angrily demanded that Tripoli repay its hard currency debt. 25X1
- Among countries less important to Moscow, [redacted] 25X1 [redacted] has complained that, contrary to prior agreement, 25X1 the USSR will not service Guinea's Soviet-made transport planes for free, but only for hard currency in advance.
- Guyana has publicly criticized Soviet industrial cooperation programs, in part because Moscow has demanded that Georgetown pay more of the hard currency expenses associated with planned projects.
- Foreign exchange constraints were one reason why Moscow is reportedly planning to scale back its military advisory program in several LDCs; no reductions have been reported as yet.
- The Dominican Republic's Communist party reportedly was told that it and some other Latin American parties would henceforth receive less funding, [redacted] 25X1 [redacted] the Ecuadorian Communist party, for 25X1 example, may have to sell Soviet-made vehicles and other goods to raise money instead of being given cash. [redacted] 25X1 [redacted] 25X1

Some Political Implications

The Soviets are certainly aware that these actions carry a political price, but they are apparently hoping that it will be bearable. In Eastern Europe, Moscow's hopes probably rest on the assumption that there is enough fat in the East European economies to enable them to adapt. East Germany and Bulgaria, for example, have been re-exporting some Soviet oil for hard currency, [redacted] As for the Third 25X1 World, Soviet qualms may be lessened by the fact that economic assistance has rarely brought substantial political benefits. Nonetheless, the Soviets cannot be certain that problems created by aid reductions will not ultimately harm their relations with their allies and threaten their influence in some important Third World countries. [redacted] 25X1

[redacted] 25X1

[redacted] 25X1

Moscow's budget cutting will, in fact, almost certainly increase tensions with Eastern Europe. Reductions in material and financial support, though still relatively modest, are worsening the region's already bleak economic prospects, raising the prospect of increased consumer dissatisfaction. Economic stagnation, already likely in several countries, will be aggravated by Soviet aid reductions and will probably sharpen the debate over increased East European contributions to Warsaw Pact force modernization. Reduced aid also will complicate Moscow's efforts to increase regional economic integration. Hungary's recent admission to the IMF in fact suggests that the Soviets may have minimized their objections to the move in view of their own reduced assistance. [redacted] 25X1

Soviet influence with some Third World clients may suffer as an already niggardly economic aid program fails to meet those countries' growing needs. Not only do the Soviets appear unwilling to take on additional burdens with major new clients such as Nicaragua, but they probably also are increasingly reluctant to bear the ones they already have. Ties with Vietnam are strained over the issue of aid, and [redacted] 25X1 Hanoi is seeking greater Western 25X1 assistance. Ethiopia and South Yemen are probably increasingly unhappy with their inability to obtain extensive Soviet cooperation in economic development. Angola, whose oil exports give it more ability than most major Soviet clients to make hard currency down payments on aid projects, is the only one to obtain a major ($2 billion) new Soviet assistance commitment this past year. Relations with Cuba, where aid-related tensions do not yet appear serious, could be affected if Cuba's economic health declines as projected. [redacted] 25X1

On the other hand, the Soviets' hard currency problem almost certainly will not substantially constrain their ability or willingness to extend military assistance in regions important to US interests or weaken their support for revolutionary movements. Moscow in fact may increase its current emphasis on arms sales and military assistance as the most effective means of competing with the United States and as an important source of foreign exchange. Hard currency sales of arms will probably be pushed more aggressively than in the past,[d] although many important customers--such as Libya and Iraq--will probably have less hard currency to spend because of deteriorating trade balances. Although Moscow may scrutinize

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[redacted] 25X1

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more carefully its concessionary military assistance, aid to major clients such as Cuba, India, and Vietnam probably will remain based primarily on political rather than economic considerations. Such a policy of arms sales and aid will almost certainly sustain the Soviets' willingness to exploit regional tensions. 25X1

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